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External debt sustainability and development

Report of the Secretary-General

Summary

The present report, prepared by the secretariat of the United Nations Conference on Trade and Development pursuant to General Assembly resolution 71/216, provides an analysis of the main trends of debt indicators in developing and transition economies for the post-crisis period 2009-2016 and presents the core drivers of continued and growing vulnerabilities to developing country debt sustainability in the context of persistent global economic instability and uncertainty. It provides an overview of current dominant policy direction and orientation to improve developing country debt sustainability in the context of increased efforts to reform development financing more widely, with a view to bridging large financing gaps to achieve the Sustainable Development Goals. The report calls attention to the need for extending debt management capacities to subnational governments to allow for more comprehensive and systematic debt data reporting, as well as minimize the dangers of hidden contingent liabilities.

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I. Overview and trends

Evolution of core debt indicators, 2009-2016

1. Total external debt stocks of developing countries and economies in transition (henceforth developing countries) are estimated to have reached $7.1 trillion in 2016, an increase of 80 per cent since 2009, which represents an average annual growth rate of 8.78 per cent over the period. In 2016, 73 per cent of total debt was composed of long-term debt, a decline of 2 percentage points compared with 2009. During the same period, the share of short-term debt in total debt increased from 21 per cent in 2009 to 25 per cent in 2016.[1]

2. As gross domestic product (GDP) growth rates picked up in the post-crisis period, the debt-to-GDP ratio remained relatively constant in the eight years since then, with an average value of 24.3 per cent. The debt-to-exports ratio increased to 114.6 per cent in 2016, from 79.4 per cent in 2011. The ratio of debt service to exports reached a low of 8.7 per cent in 2011, climbed to a high of 12.9 per cent in 2015, but registered a small improvement to 12.3 per cent in 2016. The ratio of debt service to government revenue declined from 12.8 per cent in 2009 to 9.1 per cent in 2011 and has been fluctuating in the 10-12 per cent band ever since.

3. These averages are highly influenced by China, which accounted for 20 per cent of total debt stock of developing countries in 2016. That country's debt stock grew at an average of 18.4 per cent during the period 2009-2016, and when it is excluded from the group, the growth rate of total debt stocks for developing countries drops to 7.1 per cent for the period. Although the debt stock of China rose more rapidly than the average of all developing countries, so did its GDP and exports. As a result, the debt ratios of developing countries are higher when China is excluded, with the debt-to-GDP ratio standing at 35.7 per cent, the debt-to-exports ratio at 142 per cent, the ratio of debt service to exports at 17 per cent and the ratio of debt service to government revenue at 18 per cent in 2016.

4. International reserves for all developing countries increased from nearly $5 trillion in 2009 to $6.1 trillion in 2016, although they have fallen well off their peak of $7.1 trillion, reached in 2013. The average growth rate of international reserves for the post-crisis period 2009-2016 was 3 per cent, which is substantially below the growth rate of 26.5 per cent achieved in the 2000-2008 period. The combination of rising stocks of short-term debt and falling international reserves has led to a decline in the ratio of international reserves to short-term debt, from 591 per cent in 2009 to 343 per cent in 2016. Although still substantially higher than the 230 per cent coverage registered at the beginning of the millennium, the decline in that ratio over the past five years signals that attention should be paid to the evolution of short-term debt stocks in the coming years.

5. Total debt stocks in the least developed countries registered an average yearly growth rate of 6.4 per cent in the period 2009-2016, rising from $171 billion in 2009 to $263 billion in 2016. The composition of the debt has changed in the opposite direction of that for developing countries as a group, as the average yearly growth rate of long-term debt stocks surpassed that of short-term debt stocks by 6 percentage points. The share of long-term debt increased from 80 per cent of the group's total debt in 2009 to 86 per cent in 2016, while the share of short-term debt

[1] Total external debt stocks are composed of long-term debt, short-term debt and the use of credit from the International Monetary Fund (IMF), which includes purchases and drawings under standby, extended, structural adjustment, enhanced structural adjustment and systemic transformation facility agreements, as well as trust fund loans and special drawing rights allocations. Discrepancies in overall percentage figures for short- and long-term debt stocks arise from the use of IMF credits (see also annex, footnote b, to the present report).

in total external debt declined from 12 per cent in 2009 to 8 per cent in 2016. The ratio of total debt to GDP declined from 29.3 per cent in 2006 to 27 per cent in 2016, the debt-to-exports ratio increased from 81 per cent in 2011 to 136 per cent in 2016, while the ratio of debt service to exports deteriorated progressively from 2011 to 2016 to reach 9.6 per cent, which is well below the average for all developing countries, as the group is still reaping the benefits of the Heavily Indebted Poor Countries Initiative. The ratio of debt service to government revenue increased from 7.6 per cent in 2009 to 12.7 per cent in 2016, and the ratio of international reserves to short-term debt registered an improvement, moving from 430 per cent to 567 per cent.

6. In the least developed countries in sub-Saharan Africa, the ratio of total debt to GDP remained flat throughout the 2009-2016 period, but the evolution of other debt indicators is somewhat worrying. The debt-to-exports ratio doubled from a low of 68.5 per cent in 2011 to 143 per cent in 2016, the debt service-to-exports ratio worsened substantially from 3.5 per cent in 2011 to 12.6 per cent in 2016, and the debt service-to-government revenue ratio reached a period high of 17 per cent in 2016, after being just under 5 per cent in 2011.

7. Total debt stocks in small island developing States continued to grow at an average rate of 13 per cent during 2009-2016, the second-highest rate of growth after the East Asia and the Pacific group. Long-term debt grew faster than short-term debt, resulting in the increase of the share of long-term debt in total debt stocks from 71 per cent in 2009 to 78 per cent in 2016. The debt-to-GDP ratio increased from 34 per cent in 2009 to 57 per cent in 2016, and the ratio of debt to exports rose from 93 per cent to 160 per cent. The debt service-to-exports ratio deteriorated markedly during the period, increasing from 11.5 per cent in 2009 to 25 per cent in 2016, while the ratio of debt service to government revenue increased from 18 per cent to 43 per cent during the period. International reserves in the region reached $34 billion in 2016, but the ratio of reserves to short-term debt declined from a high of 344 per cent in 2010 to 215 per cent in 2016, which is the lowest of any of the regions.

8. Total debt stocks in commodity-dependent countries grew at an average rate of 8.3 per cent during 2009-2016, in line with the average of the developing countries as a group. Most of the external debt stock is composed of long-term debt, reaching 85 per cent in 2016, which is an increase of 5 percentage points compared with 2009. Short-term debt as a share of the external debt stock decreased from 16 per cent in 2009 to 13 per cent in 2016. The collapse in commodity prices during the period 2012-2015 had a considerable impact on the group's debt indicators as the debt-to-GDP ratio increased from a low of 2.4 per cent in 2011 to 4.3 per cent in 2016, the debt-to-exports ratio almost doubled from 87 per cent to 178 per cent during the same period, the ratio of debt service to exports deteriorated from 10 per cent in 2011 to 25 per cent in 2016, and the ratio of debt service to government revenue rose from 9 per cent in 2011 to 19.5 per cent in 2016. The negative trend in ratios is also evident in the ratio of international reserves to short-term debt, which declined to 424 per cent in 2016 after reaching a high of 539 per cent in 2012.

9. In developing country petroleum exporters, the total debt stock grew at a yearly average rate of 7.3 per cent between 2009 and 2016. The period started with the debt-to-GDP ratio at 24.2 per cent, and the ratio touched a low of 19.5 per cent in 2011 and increased to 27 per cent by 2016. The same trend is evident in the debt-to-exports ratio, which more than doubled from 62 per cent in 2011 to 154.4 per cent in 2016. The oil price slump in 2014 caused the ratio of debt service to exports to increase steeply, from 13 per cent in 2013 to 26.4 per cent in 2016. As government budgets experienced lower oil-related revenues, the ratio of debt service to government revenue increased from 16 per cent in 2013 to 31.3 per cent in 2016,

which is three times higher than the figure for developing countries as a group. While the ratio of international reserves to short-term debt for the subgroup is almost double that for all developing countries, the need to use reserves to shore up domestic economies has led to a decline of 13 per cent in that ratio over the 2013-2016 period.

Official development assistance

10. In 2016 the net official development assistance (ODA) from members of the Development Assistance Committee reached its highest level to date at $146.2 billion,[2] from $131.5 billion in 2015. The increase in ODA from 2015 to 2016 represented an 8.9 per cent rise in real terms. As a percentage of gross national income (GNI), ODA reached 0.32, marking the highest ratio since 2005. This continues a long-term rising trend in ODA, amounting to 83 per cent in real terms between 2000 and 2015.

11. The increase in ODA in 2016 is driven in part by the large increase in ODA for in-donor refugee costs, which rose from $12.1 billion to $15.4 billion from 2015 to 2016, increasing from 9.2 per cent to 10.8 per cent of net ODA (an increase of 27.5 per cent in real terms). Other factors driving the increase in ODA include a substantial rise in net debt relief from $431 million in 2015 to $2.5 billion in 2016 due to exceptional debt relief delivered to Cuba. In addition, ODA allocated to humanitarian aid increased by 8 per cent in 2016 over 2015, to $14.4 billion.

12. Bilateral grants rose by 6 per cent, excluding aid for in-donor refugee costs. However, there is considerable concern over the continued downward trend of delivering aid to the poorest countries. For example, in 2016 net loans to developing countries declined by 4 per cent in real terms. Net ODA to Africa in 2016 declined by 0.5 per cent in real terms, to $27 billion, of which $24 billion was allocated to sub-Saharan Africa, representing a fall of 0.7 per cent from 2015 to 2016. In addition, bilateral net ODA to the least developed countries contracted by 3.9 per cent in real terms, to $24 billion. That trend is particularly worrisome, as the least developed countries rely heavily on ODA, which makes up more than two thirds of their external financing.

13. The increase in net ODA is a welcome development in the light of the considerable increase in financing requirements to pursue the achievement of the Sustainable Development Goals. However, while the increase in ODA is positive, it falls short of the 0.7 per cent commitment made by the members of the Development Assistance Committee.[3] Had all Committee donors delivered 0.7 per cent of their GNI, total ODA for the group would have amounted to $316.4 billion in 2016.[4] The 2016 net and gross levels of ODA fall short of that amount by $173.8 billion and $161.5 billion, respectively. Although the amount of ODA delivered by Committee members remains a modest sum compared with the financing gap for the Sustainable Development Goals, estimated at $2.5 trillion per annum[5] for developing countries, fully meeting the 0.7 per cent threshold for ODA would constitute a significant source of additional external financing for developing countries.

[2] Organization for Economic Cooperation and Development (OECD), "Development aid rises again in 2016", 11 April 2017. Available from www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2016-detailed-summary.pdf.

[3] Six countries, namely Denmark, Luxembourg, the Netherlands, Norway, Sweden and the United Kingdom of Great Britain and Northern Ireland, either met or exceeded that target in 2015.

[4] Based on the calculations of the United Nations Conference on Trade and Development (UNCTAD) using OECD 2016 ODA and GNI estimates.

[5] *World Investment Report 2014* (United Nations publication, Sales No. E.14.II.D.1). Available from http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf.

II. Macroeconomic challenges to debt sustainability for developing countries

14. In a global economic environment characterized by persistent uncertainty and volatility and continued sluggish recovery in many developed countries, stable and, on average, low debt-to-GDP ratios in developing countries as a group provide little ground for reassurance. Not only have debt-to-GDP ratios varied considerably within the group, but rising trends in the ratios of debt to exports and to government revenue, as well as of debt service to exports, in particular in some of the least developed countries and some small island developing States, point to a more problematic picture. In June 2017, only 11 low-income countries were considered at low risk of debt default by IMF and the World Bank. Four countries were considered to be in debt distress, an additional 21 countries at high risk of debt distress, compared with 13 countries in April 2015, and a further 31 at medium risk of debt default.[6]

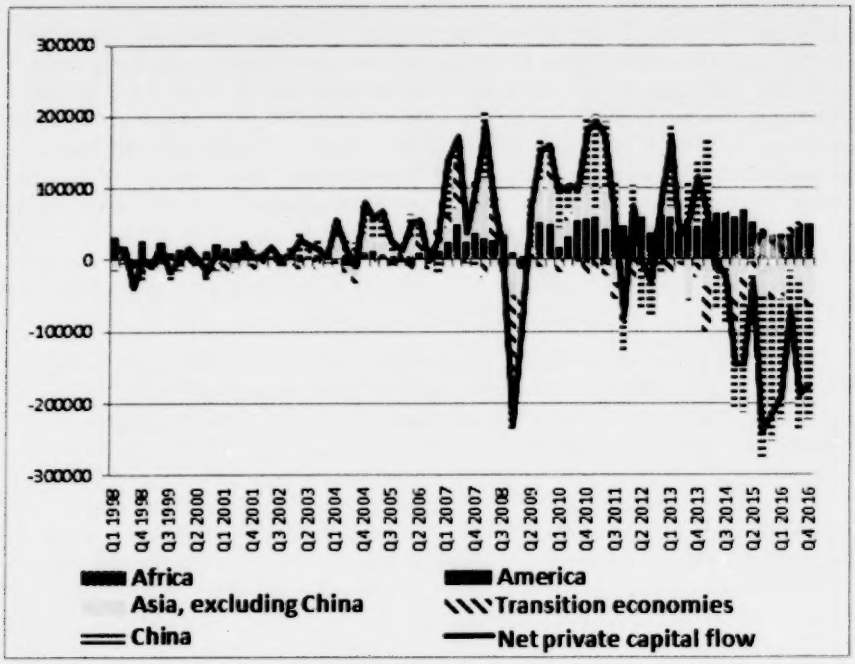
15. This is all the more concerning, given that the global macroeconomic environment remains little conducive to improved prospects of debt sustainability in developing countries in the near future. According to the latest estimates of the United Nations Conference on Trade and Development (UNCTAD), global output decelerated to 2.2 per cent in 2016, from 2.6 per cent experienced in both 2014 and 2015. A number of large emerging economies, in particular, suffered setbacks, registering weak or negative growth. Meanwhile, global trade continued to disappoint, growing at about 1.3 per cent over the year in volume terms but marked by a general decline during the first half of 2016. Although the overall outlook for the global economy has been slightly more optimistic since the start of 2017,[7] there remains uncertainty about the longer-term sustainability of that growth momentum, in particular since that bout of market optimism appears to be more the product of short-term financial herding than a measured response to a more robust global growth path.

16. The overall trend towards negative net private capital flows continues to pose a core challenge for developing economies. Net private capital flows to developing countries entered negative territory in mid-2014 and have remained negative since, despite slight improvements (see figure I). While outflows from China have dominated that trend, in particular until 2016, other developing regions are also affected by net negative capital flows or declining positive inflows. The only exception is the African region, where the relatively stable positive net capital flows are driven largely by foreign direct investment, historically delinked from shorter-term macroeconomic dynamics. Negative net private capital flows to developing countries remain a core concern in particular, in view of the expected full return to a normalized monetary and interest rate policy in the United States of America and concomitant increases in United States interest rates.

[6] See the list of low-income country debt sustainability analyses for countries eligible for Poverty Reduction and Growth Trust funding as at 1 June 2017. Available from www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf.

[7] IMF, *World Economic Outlook* (Washington, D.C., April 2017).

Figure I
Net private capital flows by developing regions, 1998-2016
(Millions of United States dollars)

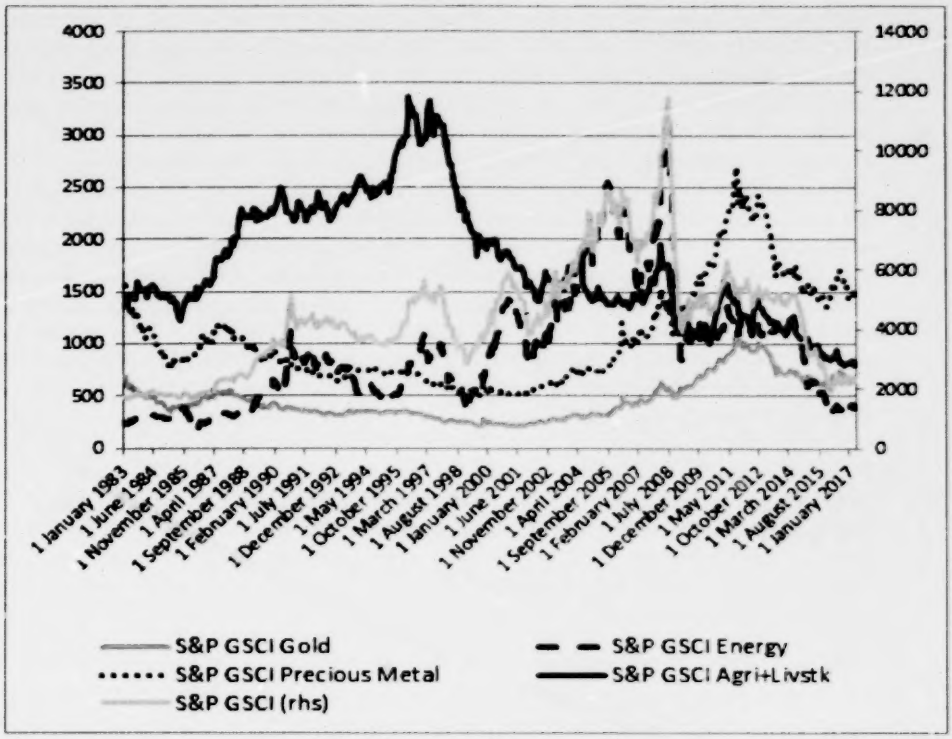


Source: UNCTAD secretariat calculations based on the IMF Balance of Payments database and information from national central banks.

Note: The samples of economies by country group are as follows: transition economies: Kazakhstan, Kyrgyzstan, Russian Federation and Ukraine; Africa: Botswana, Cabo Verde, Egypt, Ghana, Mauritius, Morocco, Mozambique, Namibia, Nigeria, South Africa, Sudan and Uganda; Latin America: Argentina, Bolivia (Plurinational State of), Brazil, Chile, Colombia, Ecuador, El Salvador, Mexico, Nicaragua, Paraguay, Uruguay and Venezuela (Bolivarian Republic of); Asia, excluding China: Hong Kong (China), India, Indonesia, Jordan, Lebanon, Malaysia, Mongolia, Pakistan, Philippines, Republic of Korea, Saudi Arabia, Singapore, Sri Lanka, Thailand, Turkey and Viet Nam.

17. Of further concern, in particular for commodity-exporting developing countries, are continued low commodity prices. All indications point to commodity prices only slowly recovering from their earlier very low levels, and in some cases not recovering at all. In real terms, commodity prices globally are at the levels of the late 1980s, albeit with major variations in the dynamics of the different commodity groups. In particular, agricultural commodities are at one of their lowest levels since the creation of the index in 1970. The only group of commodities currently performing above 1980s price levels are precious metals, including gold, silver and platinum. With persistently low levels of aggregate global demand, expectations of a sustained improvement of commodity price levels over the coming months would clearly be premature.

Figure II
Commodity indices in real terms, 1983-2017



Source: UNCTAD secretariat calculations and Thomson Reuters.

18. Those exogenous constraints are likely to accentuate growing risks for developing country debt sustainability arising from the changing composition of developing country debt.[8] Over the past two decades, a growing share of developing country debt, both public and private, has been refinanced in international financial markets, considerably increasing their risk exposure to volatile investor sentiments and short-term expectations in those markets. In terms of sovereign debt, the share of external public and publicly guaranteed debt owed to private creditors increased from 41 per cent in 2000 to just over 62 per cent in 2016, remaining stable compared with 2015. With the drying up since 2014 of cheap private credit to developing countries (see figure I) resulting in steep yield increases on international sovereign bonds in some cases, in addition to the high exchange rate risk associated with debt issuance in foreign currency, many Governments in developing countries have relied more strongly on domestic public debt, issued in local currency. However, that strategy comes with its own risks, such as inflationary pressures and maturity mismatches, arising from the prohibitive costs of long-term government securities in most developing countries. In addition, where foreign investors hold large positions in domestic bond markets, exposure to volatile global financial and economic conditions and fickle investor confidence in host markets still remains high.

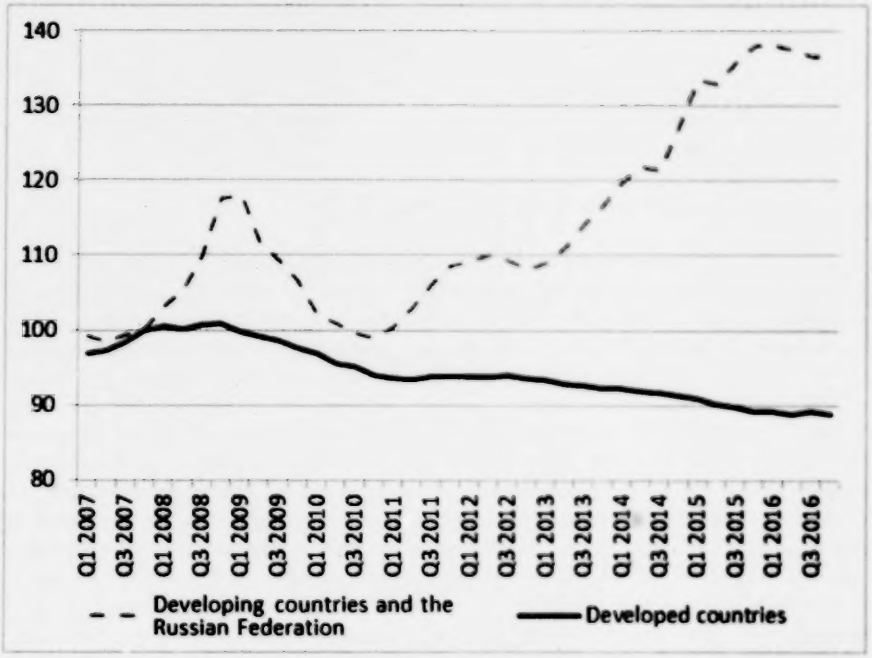
19. In large developing economies and emerging markets, private sector non-financial debt, reaching over 140 per cent of combined GDP in 2016, and

[8] For a detailed discussion of those risks, see the previous report of the Secretary-General on the subject (A/71/276).

concomitant rising debt service ratios also continue to be a major concern for external debt sustainability in those economies. Figure III shows the evolution of debt service ratios of private non-financial sectors in those and in advanced countries between 2007 and 2016. With the exception of South Africa, not only is the debt service ratio currently higher in large developing and emerging economies, compared with levels prior to the global financial crisis, but the trend is also overwhelmingly rising. Most of the rising debt service ratios are attributable to increases in corporate indebtedness contracted mostly, with the exception of China, in international financial markets and in foreign currency. Rising household debt at the moment poses a more serious problem only in some East and South-East Asian economies. That trend is worrying, since debt service ratios are an early warning indicator of banking crises due to non-performing loans, with high debt service ratios also usually affecting consumption and investment negatively. In addition, private non-financial sectors in low-income countries have also seen a rise in external financing. According to the World Bank, in those economies the share of private non-guaranteed debt in total external debt increased from 0.37 per cent in 2000 to 3.59 per cent in 2015.[9]

Figure III

Debt service ratios in the private non-financial sector, selected developed and developing countries, 2007-2016 (index numbers, Q4 2007 = 100)



Source: UNCTAD secretariat calculations based on information from the Bank for International Settlements.

Note: The figure shows average values for developing and transition countries (Brazil, China, India, Indonesia, Mexico, Malaysia, Russian Federation, South Africa, Thailand and Turkey) and for developed countries (France, Germany, Japan, the United Kingdom of Great Britain and Northern Ireland and the United States of America).

20. That combination of a problematic global economic environment and higher risk exposure due to longer-term shifts in developing country debt compositions has

[9] World Bank International Debt Statistics 2017.

been driving the deterioration of developing country external debt sustainability for some time. This raises the question of whether short and procyclical credit booms, which by their very nature are not easily channelled into productive long-term investment projects, can make up for the potential costs of rising risk exposure, in particular in developing countries with as yet shallow financial systems at home. The alternative is the emergence of a new debt trap for developing countries: once reversals of capital flows and worsening financial conditions set in, systemic failure in the private sectors leads to heavy additional debt burdens on public balance sheets, including bailout payments. Even if an outright financial meltdown can be avoided, private lenders are less obliging than other Governments when it comes to considering trade-offs between longer-term growth prospects and immediate repayment. Harsh austerity responses are therefore likely, further undermining growth prospects and ultimately driving up relative debt levels. To avoid such debt trap from systematically spreading across the developing world, coordinated policy responses are required.

III. Current international policy initiatives to mitigate developing country debt vulnerabilities: main directions

State-contingent debt instruments

21. Recent initiatives by the international community to improve developing country debt sustainability have focused primarily on the prevention of debt crises. This includes renewed interest in debt instruments that help to mitigate exogenous shocks to developing economies, in particular State-contingent debt instruments.[10] These are financial instruments whose pay-offs are contractually linked to a State variable (such as GDP or inflation) or to a trigger event (such as a natural disaster or a health epidemic). Since such instruments are designed to provide a countercyclical and risk-sharing function, they are, in principle, particularly useful in mitigating debt sustainability problems arising from the kind of short cheap credit booms experienced by developing countries in the recent past, as well as other exogenous shocks, so long as their nature can be predefined in the contractual arrangements.

22. The most important potential benefit of State-contingent debt instruments for borrowing countries is the stabilization of overall government spending, which helps to preserve fiscal space in times of crises. Insofar as such instruments are also a vehicle for risk sharing between debtors and creditors and such risk sharing helps to reduce the likelihood of costly defaults and debt crises, both debtors and creditors benefit in the long run. An example is GDP-linked bonds, which link debt payments directly to the GDP growth rate or level of the issuing countries, thereby providing Governments with a break on their debt service obligations in bad times in exchange for increased debt service obligations in better times. IMF suggests that switching to local currency and GDP-linked bonds can therefore help to increase the debt limits (i.e. the debt level beyond which fiscal solvency is in doubt) in developing countries.[11] Other research by the Bank of England shows that if GDP-indexed bonds had been issued by Mexico before the 1995 tequila crisis, it would have reduced the Government's interest bill by almost 2 per cent of GDP.[12]

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[10] See, for the most recent example, IMF, "State-contingent debt instruments for sovereigns — annexes", Policy Paper (Washington, D.C., May 2017). Available from https://www.imf.org/en/Publications/Policy-Papers/Issues/2017/05/19/pp032317state-contingent-debt-instruments-for-sovereigns.

[11] Ibid.

[12] See www.bankofengland.co.uk/research/Documents/conferences/gdplinkedbonds.pdf.

23. State-contingent extendible bonds function differently in that they automatically provide maturities extension or a debt service standstill in times of liquidity crises. This can help to generate "temporary financing" and prevent liquidity issues from escalating into a full-blown and costly debt crisis. There are many other types of State-contingent debt instruments, such as output-, revenue- or inflation-linked instruments, countercyclical loans, commodity-linked instruments and catastrophe insurance, that target different types of vulnerabilities of sovereign debt sustainability.

24. The main challenge for State-contingent debt instruments is the difficulty of establishing investor confidence therein, with so far only limited take-up by creditors, so that markets for such instruments are either highly illiquid or non-existent. Additional concerns relate to moral hazard risks and data quality and transparency. IMF suggests that at least some of the problems can be addressed through the refined pricing and designing of such instruments to achieve an acceptable balance of risk for both investors and issuers.

25. If this could be achieved, State-contingent debt instruments would certainly strengthen market-based approaches to addressing debt sustainability issues through debt crisis prevention. Other market-based solutions, such as collective action and pari passu clauses in sovereign bond contracts, also focus on refinements to international bond contracts but do so from the perspective primarily of facilitating the resolution of sovereign debt crises once they occur, and in particular by discouraging non-cooperative holdout strategies in sovereign debt restructurings.

Promoting responsible financing through "soft law"

26. Another policy focus of the international community has been the promotion of "soft law" principles to encourage responsible sovereign lending and borrowing, including the UNCTAD principles for responsible sovereign lending and borrowing (2012), the Basic Principles on Sovereign Debt Restructuring Processes, adopted by the General Assembly in 2015 in its resolution 69/319, and the operational guidelines for sustainable financing of the Group of 20 (2017).

27. Such principles and guidelines provide normative frameworks for best practice in sovereign lending and borrowing, based on the application of established general international legal norms and custom, such as transparency, legitimacy, impartiality, good faith and sustainability,[13] to the governance of sovereign debt and debt sustainability issues. The primary objective is to broaden consensus on what constitutes responsible behaviour by both creditors and debtors to reduce incidences of sovereign debt crises, as well as to promote shared responsibilities, a more transparent process and fairer and more efficient outcomes for debt crisis resolution.

28. Soft-law approaches have the potential to increase the developmental impact of sovereign borrowing while reducing its risks and costs, by setting standards for the constructive behaviour of actors participating in sovereign lending and borrowing, delineating their roles and providing guidance for improved institutional governance of sovereign debt. They can also promote a more holistic understanding of sovereign debt sustainability criteria, as well as of the objectives of sovereign workout processes when those become necessary, by emphasizing the need to consider not only immediate burden sharing between creditors and debtors to address short-term liquidity problems but also the explicit consideration of the

[13] For a detailed discussion of these principles, see Juan Pablo Bohoslavsky and Matthias Goldmann, eds., Yale Journal of International Law, special ed. on sovereign debt, vol. 41, No. 2 (Fall 2016). Available from https://campuspress.yale.edu/yjil/files/2016/10/YJIL-Online-Special-Edition-Sovereign-Debt-Full-File-tl8u6b.pdf.

longer-term social, economic and environmental implications of sovereign debt financing and debt restructurings.

29. Since the use of soft-law principles and guidelines has the benefit of being voluntary, and therefore based on the consensual agreement of sovereign borrowers and their creditors, as well as negotiated in advance of any risk of insolvency, the bar for their adoption is relatively low. However, to be effective in the prevention of systemic debt crises, widespread adoption and systematic implementation are essential, but remain uncertain, as well as difficult to monitor. There are a number of different, but in principle complementary, methods to enhance the effective implementation of normative frameworks and best practice guides. They could be incorporated in advance into contract choice-of-law clauses for sovereign debt bonds; coordinated efforts could be stepped up to facilitate their dissemination and the build-up of national institutional and regulatory mechanisms for systematic implementation; and adjudicative bodies (i.e. domestic courts or arbitral tribunals) could take such guidelines into consideration in their own actions and decision-making.

Reforming official development assistance and new solutions for development financing

30. At least partly in response to increased financing requirements to meet the Sustainable Development Goals, the use of blended finance and related new financing instruments has been widely promoted, including through the Sustainable Development Goals financial innovation platform launched in October 2016 by the former Secretary-General, Ban Ki-moon. The objective is to use conventional bilateral and multilateral development finance with a strategic view to facilitating the mobilization of private capital into investment projects with a high developmental impact.[14] Blended finance instruments are wide-ranging and not always entirely new, and include public-private partnership, public guarantees, "impact investing", syndicated loans, and shares in collective investment vehicles, to name a few.

31. To track such additional financing, OECD has spearheaded the development of a new metric, total official support for sustainable development, which aims to measure all external financial flows from traditional and emerging donors (public, private or blended, and concessional or non-concessional) that are delivered to support global public goods and sustainable development in developing countries. The related statistical framework seeks to support target 17.3 of the Sustainable Development Goals (Mobilize additional financial resources for developing countries from multiple sources). The new framework is intended to complement existing statistics provided by Development Assistance Committee donors, rather than to replace ODA, and has yet to be finalized and refined. It seeks to measure donors' gross contributions relative to the financing needs of recipient countries. Much work remains to be done in terms of setting statistical classifications and boundaries, ensuring the compatibility of new and existing relevant statistical databases and identifying eligible countries, sectors and organizations to ensure that data are relevant, comparable and sound.[15]

32. In the course of ongoing publications[16] on the new framework, a number of concerns were raised. Most of them focus on the transparency of the framework and

[14] See World Economic Forum and OECD, "Blended finance vol. 1: a primer for development finance and philanthropic funders — an overview of the strategic use of development finance and philanthropic funds to mobilize private capital for development", September 2015.

[15] See OECD, "TOSSD: a new statistical measure for the SDG era", October 2016. Available from www.oecd.org/dac/financing-sustainable-development/tossd.htm.

[16] See www.oecd.org/dac/financing-sustainable-development/tossd-public-consultation.htm.

on clear and separate accounting of the longer-term costs and benefits of different types of financial flows and financing instruments and their true developmental impact. A specific concern in this regard relates to concerns about the continued "additionality" of conventional ODA and the potential risk of donor countries downsizing their aid allocations by replacing ODA with other forms of financing under the aforementioned framework, thereby further undermining compliance with the United Nations target of 0.7 per cent of GNI for ODA. In addition, critiques have pointed to the broad scope of the financial flows under the framework more generally, arguing that this dilutes the core economic functions of development finance and the focus on Sustainable Development Goals delivery by diverting development finance into related, but also much wider, areas, such as conflict resolution.

33. While these are, of course, not the only policy initiatives to mitigate debt sustainability vulnerabilities and facilitate development financing — others include the ongoing review of the IMF Debt Sustainability Framework and IMF initiatives that facilitate access to debt relief and allow lending into arrears in very specific circumstances — they describe the scope of current policy direction and orientation that address sovereign debt sustainability issues in the context of increased financing requirements to meet the Sustainable Development Goals. Whether the emphasis on market-based approaches and the strategic use of development finance to mobilize private capital will be sufficient to avoid the rapid spread of the current debt trap for developing countries remains to be seen. The danger at present is of a mismatch between very gradual, largely market-based reforms of debt and financing instruments, on the one hand, and the growing urgency of sovereign debt vulnerabilities and distress in developing countries, on the other. Thus, as pointed out, liquid markets for State-contingent debt instruments are far from emerging in sufficient scope and breadth. Meanwhile, recent evidence shows that the increase in the corporate debt of emerging and large developing countries has not been used to finance productive activities but has instead been channelled mostly into very few sectors with an, at best, ambiguous impact on long-term productivity and transformational investment.[17] In addition, an OECD survey of blended finance instruments found that they had mobilized an estimated $36.4 billion of private capital over three years (2010-2014), a far cry from the estimated annual financing gap for the Sustainable Development Goals of $2.5 trillion.

IV. Debt management: strengthening capacity in subnational governments

34. By contrast, it is uncontentious that more complex compositions of public debt in developing countries have reinforced the need for strong institutional and human capacity for debt management. Debt management offices need to be effective in fulfilling their reporting obligations and in providing decision makers with the information required for the formulation of critical financial policies. Debt management must also be supported by appropriate legal and institutional frameworks and be fully integrated within the broader public finance management system. When effective, public debt management significantly contributes to improvements in financial sustainability, transparency and good governance.

35. Developing countries have generally strengthened their capacity to oversee and analyse their debt portfolios over the period, although the rate of progress differs greatly between countries.[18] However, the growing recognition of the need

[17] *Trade and Development Report 2016* (United Nations publication, Sales No. E.16.II.D.5), chap. V.
[18] For more details, see A/70/278, sect. VI.

for Governments to take a holistic approach to debt sustainability in their countries has reinforced awareness of the importance of debt management for governments at the subnational level, in particular. Moreover, the trend towards decentralization of debt management from the central Government to subnational governments, aligned with increased fiscal authority, has focused attention on the capacity of the latter to manage their liabilities.

36. Any subnational government that has the capacity to incur debt must also have the capacity to manage that debt effectively. However, the specific capacity that such governments need for effective debt management will depend on a number of factors. The intergovernmental framework of the country will have important implications for debt management at the subnational level. While the types of legislation differ between countries, in federal systems the second tier of government will often have more freedom to determine its borrowing frameworks than in unitary systems where the central Government would normally establish the regulatory framework for borrowing by subnational governments. Notwithstanding the different degrees of autonomy, it is essential that a legal framework exist that clearly defines the scope of the subnational government to borrow, the rules governing borrowing, and reporting obligations. Another significant factor is the size of the subnational government in terms of incurred debt; small subnational governments may not have one principal debt management entity but instead combine debt management functions with other related functions. In such cases, coordination between the different entities is critical. The size of the subnational government will also determine the need for coordination with the fiscal and monetary policies and debt sustainability strategies of the central Government. Other important factors are the fact that subnational governments typically borrow from banks, normally commercial, and do not borrow from the domestic capital market or pursue market development.

37. While the capacity of subnational governments to manage their debt varies from entity to entity, and indeed from country to country, there are important commonalities. As the size of public debt has increased at the subnational level and the composition of debt portfolios has become more complex, subnational governments in general are conscious of the need to strengthen the effectiveness of their debt management, and many are making substantial progress in doing so. There is a marked lack of information about the current status of debt management capacity in developing countries; however, anecdotal evidence suggests that many subnational governments in those countries face considerable challenges to managing their debt portfolios effectively. Progress made at the level of the central Government in strengthening capacity to oversee and analyse its debt portfolios does not seem to have been replicated at the subnational level in a number of countries.

38. Although many of the challenges are similar to those encountered by central Governments, particularly those with weak debt management functions, some are specific to subnational governments, and others are frequently more acute. Subnational governments often lack the legal and institutional frameworks necessary for effective debt management, and a large number have not yet established an adequately resourced debt management office. The problems of lack of competencies and high turnover among debt management office staff are in many cases more acute than in the central Government. In terms of upstream debt management, the major weaknesses tend to be in the formulation of debt strategy and in risk management. For downstream debt management, a common problem is incomplete or inaccurate debt data, often associated with the absence of a computerized debt recording and management system; while spreadsheet systems suffice for subnational governments with very low quantities of debt, a more

sophisticated system is essential for most entities. Debt reporting is another critical area in which many subnational governments lack the required capacity. Unlike the central Government, the subnational government would not normally be expected to report to international institutions, such as the World Bank; however, a major problem is that many fail to meet their obligations to report to the central Government. One of the challenges faced by many subnational governments is that they do not have strong technological skills or telecommunications infrastructures and therefore have difficulty in managing such systems. Operational risk management is also a common area of weakness, characterized by the absence of controls and documented procedures for debt transactions. As with the central Government, the subnational debt management system should ideally be linked electronically to the other public finance management systems, but such is frequently not the case.

39. In the post-2015 environment, it is critical for both the local and central governments that subnational governments build the capacity that they need to manage their debt effectively. They need to have appropriate legal and institutional frameworks, as well as the staffing, skills and systems needed to meet the challenges that they face. Central Governments should ensure that governance structures and regulatory frameworks reflect the country's particular situation and clearly define the level of autonomy and scope for borrowing given to subnational governments. The central Government and the international community should assist subnational governments in their efforts to build sustainable capacity, initially with particular attention to debt data recording and reporting, to ensure the availability of information needed for policymaking and risk management. Given the broad consensus that technical assistance has been a major contributing factor in improving debt management capacity at the level of the central Government, it is proposed that providers of technical assistance in debt management also provide valuable support to subnational governments in building sustainable capacity to meet international standards. Such support should cover both upstream and downstream activities. The upstream activities include diagnosis, designing reform plans, medium-term debt strategy formulation and debt sustainability analysis, of which the principal providers are the World Bank and IMF, in partnership with a number of other international and regional organizations, to a large extent through the Debt Management Facility. Downstream activities cover the provision of debt management systems, maintenance of debt databases, debt data validation, debt operations, internal and external debt reporting, debt statistics and basic debt analysis and are provided mainly by the Debt Management and Financial Analysis System Programme of UNCTAD and by the Commonwealth Secretariat.

40. There are a number of critical success factors for the improvement of debt management capacity in subnational governments. Central Governments should ensure that the legal and institutional frameworks appropriate to the country's situation are in place. Capacity-building should be customized to take account of the specific characteristics of subnational debt in each country. Providers of technical assistance should work in cooperation with the central Government and with each other to avoid duplication and maximize economies of scale; Argentina, where the United Nations and the central Government established a partnership to support debt management in a number of provinces, is a clear example of the benefits that can be achieved through such cooperation. Priority should be given to assisting countries in which national solvency and liquidity vulnerabilities related to subnational debt are highest. Lastly, adequate financing from the international community will be needed in many cases to support reforms and the provision of technical assistance.

V. Conclusions and policy recommendations

41. The overall outlook on external debt sustainability in developing countries is worsening. While GDP-to-debt ratios remain stable and low by historical standards, this conceals both large and growing variations between developing countries and the effects of continued high exposure to market risks due to changes in debt compositions and fast integration into international financial markets. In the context of sluggish global economic and trade growth, sustained net negative capital flows to developing countries, flat commodity prices with few or no signs of speedy recovery, an expected tightening of monetary policies in developed countries, and instances of debt distress or high risk thereof in developing countries are likely to spread further.

42. Current main policy initiatives at the international level to bolster developing country debt sustainability and mobilize additional resources for development finance, while welcome and useful, may prove too gradual to contain the danger of a new debt trap closing in on a growing number of developing countries, in particular if global economic conditions remain unchanged. In addition, coordinated and more proactive international policy action is required to provide alleviation from acute debt distress, minimize contagion and ensure fair and efficient sovereign debt workouts. Further analysis of options for immediate international policy coordination and enhanced debt relief mechanisms should be considered, with input from major institutional stakeholders, including IMF, the World Bank and UNCTAD, in accordance with their respective mandates.

43. Further improvements in debt data availability, quality and country coverage, in particular on different debt components and debt financing instruments, remain an urgent priority, not only to better assess the short- and long-term sustainability of developing country debt but also to improve debt management strategies and facilitate sovereign debt restructurings. Similarly, more substantial analyses of the effectiveness of blended finance tools in mobilizing private capital for long-term productive investment in developing countries will be important, to ensure that such tools mitigate rather than increase risks to developing country debt sustainability. Clear definitions of different types of concessional and non-concessional, public, private and blended financing instruments will be important, to ensure that ODA commitments are not further undermined and the use of ODA for core economic development purposes is not diluted. Further analysis of options for an enhanced approach to blended finance and international development cooperation that can be operationalized should be considered, with input from the major institutional stakeholders, including IMF, the World Bank and UNCTAD, in accordance with their respective mandates.

44. Lastly, the strengthening of debt management capacities in developing countries remains essential to improved debt sustainability, including through improved debt data coverage and quality. Extending such capacities more systematically to subnational governments in developing countries should be a priority, to ensure more comprehensive data reporting and to minimize the dangers of hidden contingent liabilities in a context of increased decentralization of debt management in many developing countries.

Annex

External debt of developing countries

(Billions of United States dollars)

	All developing countries[a] and countries with economies in transition					*Sub-Saharan Africa*				
	2009-2016	*2013*	*2014*	*2015*	*2016[b]*	*2009-2016*	*2013*	*2014*	*2015*	*2016[b]*
Total external debt stocks[c]	6 005.5	6 804.7	7 257.7	6 863.5	7 101.3	365.2	387.3	410.2	426.3	465.7
Long-term debt	4 199.1	4 579.0	4 916.4	4 922.4	5 205.4	292.8	309.2	334.7	349.0	385.8
Short-term debt	1 669.6	2 094.5	2 224.6	1 824.6	1 776.5	51.6	56.1	55.1	57.9	58.1
Debt service	681.9	721.6	800.2	840.5	763.4	25.2	32.2	32.6	29.1	30.0
International reserves	6 259.8	7 079.6	6 986.6	6 357.3	6 092.1	184.0	209.8	195.1	174.7	164.8
Debt indicators (percentage)[d]										
Debt service/exports[e]	10.8	10.0	10.9	12.9	12.3	6.1	6.8	6.9	8.1	9.1
Total debt/exports	93.9	93.9	98.8	105.5	114.6	89.4	81.9	86.6	119.3	141.3
Debt service/GDP	2.8	2.6	2.8	3.1	2.8	1.7	1.9	1.9	1.8	2.0
Total debt/GDP	24.3	24.9	25.7	25.6	26.3	24.5	23.2	23.6	26.9	30.6
Debt service/government revenue	10.6	9.8	10.7	12.0	11.1	8.3	9.4	9.5	10.2	12.0
Reserves/short-term debt	395.2	338.1	314.1	348.5	343.0	366.4	379.5	359.5	305.9	287.5

	Middle East and North Africa					*Latin America and the Caribbean*				
	2009-2016	*2013*	*2014*	*2015*	*2016[b]*	*2009-2016*	*2013*	*2014*	*2015*	*2016[b]*
Total external debt stocks[c]	181.7	190.9	189.4	197.5	208.1	1 561.7	1 691.8	1 864.7	1 879.8	1 948.1
Long-term debt	136.1	148.5	142.8	149.9	154.5	1 283.2	1 384.4	1 538.9	1 564.7	1 634.0
Short-term debt	36.0	32.9	36.4	36.8	40.3	254.1	281.2	301.4	292.1	296.3
Debt service	18.2	16.9	19.1	18.8	20.0	210.5	224.5	220.5	260.8	269.5
International reserves	401.9	431.5	428.1	393.0	365.0	758.6	817.8	844.7	799.3	818.9
Debt indicators (percentage)[d]										
Debt service/exports[e]	5.8	4.6	5.9	7.3	7.7	19.3	18.1	18.2	24.8	26.4
Total debt/exports	57.9	51.8	58.1	76.2	79.8	142.0	136.5	153.7	178.3	190.4
Debt service/GDP	1.5	1.3	1.5	1.6	1.7	3.9	3.7	3.6	4.9	5.2
Total debt/GDP	15.0	14.5	15.0	16.6	17.5	28.7	28.1	30.7	35.6	37.4
Debt service/government revenue	6.9	6.5	6.9	7.7	8.6	14.0	12.8	13.1	18.6	20.1
Reserves/short-term debt	1 123.7	1 310.7	1 175.2	1 066.8	905.0	301.7	290.6	280.0	273.6	276.2

	East Asia and the Pacific					*South Asia*				
	2009-2016	*2013*	*2014*	*2015*	*2016[b]*	*2009-2016*	*2013*	*2014*	*2015*	*2016[b]*
Total external debt stocks[c]	1 916.6	2 261.0	2 612.4	2 273.8	2 343.7	532.3	569.7	607.2	637.1	677.7
Long-term debt	905.4	942.2	1 136.7	1 135.4	1 254.7	423.0	444.5	489.3	521.3	555.5
Short-term debt	991.5	1 298.5	1 456.7	1 120.1	1 070.7	91.8	109.2	103.3	100.6	106.0
Debt service	152.3	156.3	172.0	231.3	177.2	50.6	51.0	106.5	57.3	61.2
International reserves	3 786.2	4 413.4	4 414.5	3 889.7	3 621.3	368.8	345.4	385.5	424.9	436.6
Debt indicators (percentage)[d]										
Debt service/exports[e]	5.1	4.6	4.8	6.8	5.5	10.0	9.2	19.2	11.4	11.7
Total debt/exports	62.8	67.3	73.5	66.9	72.9	108.1	102.8	109.3	126.4	130.1
Debt service/GDP	1.4	1.3	1.4	1.7	1.3	2.1	2.2	4.1	2.1	2.2
Total debt/GDP	17.6	19.1	20.5	17.2	17.4	22.6	24.2	23.6	23.7	24.0
Debt service/government revenue	5.6	5.0	5.1	6.4	4.9	11.3	11.8	22.8	11.3	10.7
Reserves/short-term debt	428.2	339.8	303.0	347.2	338.2	419.3	316.2	373.1	422.2	412.0

	Europe and Central Asia					*Least developed countries*				
	2009-2016	*2013*	*2014*	*2015*	*2016[b]*	*2009-2016*	*2013*	*2014*	*2015*	*2016[b]*
Total external debt stocks[c]	1 448.0	1 703.9	1 573.7	1 449.0	1 457.9	208.1	216.0	229.6	242.9	262.6
Long-term debt	1 158.6	1 350.1	1 274.1	1 202.2	1 220.9	174.8	182.0	196.6	207.8	224.8
Short-term debt	244.7	316.6	271.6	216.9	205.0	19.4	19.7	19.7	22.5	21.3
Debt service	225.1	240.8	249.5	243.2	205.5	11.9	12.3	14.9	14.2	18.5
International reserves	760.3	861.7	718.6	675.6	685.4	109.0	126.9	118.9	117.3	117.0
Debt indicators (percentage)[d]										
Debt service/exports[e]	22.2	19.2	20.4	26.2	24.3	5.8	5.0	6.0	7.1	9.6
Total debt/exports	140.7	135.9	128.9	155.8	172.2	101.9	88.6	93.2	121.7	135.9
Debt service/GDP	6.9	5.8	6.4	8.4	7.4	1.4	1.4	1.6	1.5	1.9
Total debt/GDP	43.6	41.4	40.6	50.1	52.4	25.7	24.9	24.4	26.3	27.2
Debt service/government revenue	20.3	16.9	19.0	25.4	22.4	7.7	6.9	8.0	9.2	12.7
Reserves/short-term debt	315.4	272.2	264.6	311.4	334.3	590.7	667.4	626.9	538.0	566.9

Source: United Nations Conference on Trade and Development calculations based on the World Bank International Debt Statistics 2017 online database.

Abbreviation: GDP, gross domestic product.

[a] As defined in the International Debt Statistics publication.

[b] 2016 estimates.

[c] Total debt stocks include long-term debt, short-term debt and use of credit from the International Monetary Fund.

[d] Data used for ratio calculation have been adjusted on the basis of country data availability.

[e] Exports comprise exports of goods, services and primary income.